DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 99-0656
Adjusted Gross Income Tax – Unitary (Combined) Filing Status
Fiscal Years 1994 and 1995

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ISSUES

I. Adjusted Gross Income Tax—Unitary Filing Status

Authority: *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983)
IC 6-3-2-2(l); IC 6-3-2-2(p); IC 6-3-2-2(q)
35 ILCS 5/1501(a)(27); Tenn.Code Ann. § 67-4-2004(25)(B)

Taxpayer protests the Audit Division's subsequent disallowance of unitary combined filing status, for purposes of the taxpayer's combined adjusted income tax return for fiscal years 1994 and 1995, on the basis that the combined return inaccurately reported taxpayer's Indiana source income.

II. Adjusted Gross Income Tax—Unitary Filing Status—Retroactive Withdrawal of Permission to File Unitary

Authority:
IC 6-3-2-2

Taxpayer claims that if the Department finds that it does not qualify to file on a unitary basis with its parent corporation and the members of the recreational vehicle group for Indiana tax purposes, then alternatively taxpayer and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question

should have been allowed to file on a consolidated basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns.

III. Adjusted Gross Income Tax—Consolidated Returns

Authority: None

Taxpayer claims that the Department erred in requiring taxpayer and the five additional members of the recreational vehicle group that filed Indiana tax returns to file separate tax returns.

IV. Adjusted Gross Income Tax — Throwback Sales

Authority: *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992); *Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754 (Ind. Ct. App. 1980)
IC 6-3-2-2; IC 6-8.1-5-1
45 IAC 3.1-1-64
Public Law 86-272 (15 U.S.C.A §381-385)

Taxpayer raises for the first time at hearing the following issue: whether taxpayer and the original members of the recreational group that filed Indiana tax returns erred in classifying sales to states other than Indiana as throwback sales.

STATEMENT OF FACTS

Taxpayer's parent corporation (hereinafter, "Parent") is a holding company for various companies located in the United States and Canada which manufacture recreational vehicles. By a letter dated August 25, 1995, Parent petitioned the Department of Revenue for permission to file a combined return with all fourteen of its recreational vehicle subsidiaries (hereinafter referred to collectively as the "RV Subsidiaries") based upon the premise that they formed a unitary group. In its petition, Parent maintained that the RV Subsidiaries were one hundred percent (100%) owned by Parent; that the entities are all engaged in the same line of business; that the entities share common directors and common management; and, that filing separate company returns would not fairly reflect Indiana income.

In a letter dated October 10, 1995, and based upon the information submitted by Parent, the Indiana Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. Specifically, the Department found that Parent and the five members of the RV Subsidiary that filed Indiana income tax returns met the unity requirements through their unity of ownership, centralized management, and centralized financial, administrative and operational services. (*See Department of Revenue-Tax Policy Division Letter* dated

October 10, 1995, page 2). The Department further found that Parent and the five subsidiaries met the "best method for reporting adjusted gross income" test through their shared industry impact on Indiana adjusted gross income and their non-arms length transactions. *Id*. The Department determined that the remaining nine subsidiaries could not be included in the unitary group or taxed by Indiana because they did not have sufficient contacts with the state of Indiana. Although the Department granted Parent's request, in part, to file unitary, it nevertheless, reserved the right to revoke its grant of permission for unitary combined filing in the event that, *inter alia*, the facts subsequently established by the Department disclosed material error or misrepresentation of the facts set forth in Parent's original petition. (*See Department of Revenue-Tax Policy Division Letter* dated August 30, 1995, page 3).

In a letter dated March 2, 1996, Parent re-petitioned the Department for permission to file combined returns with all of the RV Subsidiaries. In its letter dated March 20, 1996, the Department denied Parent's second petition, and reiterated that permission was granted for only five of the fourteen subsidiaries. Thereafter, Parent filed unitary combined returns including the five subsidiaries beginning in the fiscal year ending July 31, 1995. In fiscal year ending July 31, 1995, Parent also included one additional company in its combined returns. The additional company is the "taxpayer" in the instant case.

In 1998, Parent amended its 1995 and 1996 Indiana tax returns to expand its combined filings to include all fourteen of its RV Subsidiaries. Parent based its amended returns on its position that the Department had erroneously failed to grant it permission to file combined Indiana income tax returns with the RV Subsidiaries.

As stated above, the "taxpayer" in the instant case is an Indiana subsidiary of Parent and the additional company that Parent included in its unitary combined returns for fiscal year 1995, along with the five RV subsidiaries originally permitted to be included in the combined filings. The audit of taxpayer stems from an audit that was performed on the combined filings of Parent and its RV Subsidiaries for fiscal years 1995 through 1997 (which included the 1995 and 1996 amended returns). The disallowance of Parent's combined filings resulted in separate filing reports being generated for the subsidiaries that were originally granted permission to be included in the combined filing. The audit of taxpayer is of one such separate filing.

Pursuant to the audit performed on taxpayer, the auditor found that the expenses incurred by Parent on behalf of its subsidiary were properly reflected in the books of the subsidiary. As such, the Department determined that the Indiana income of taxpayer was more fairly reflected by filing separate company returns.

I. Adjusted Gross Income Tax—Unitary Filing Status

DISCUSSION

Taxpayer protests the Department's determination that it may not file unitary combined returns for the fiscal years in question. Taxpayer argues that the combined reporting is

the only filing method that fairly represents the flow of value from functional integration, centralized management, and economies of scale, present between taxpayer, Parent, and the remaining RV Subsidiaries.

In addressing this question, we examine: (1) whether a unitary relationship actually existed between Parent, taxpayer, and the remaining RV Subsidiaries; and (2) whether filing a combined return would more fairly represent the Parent's, taxpayer's, and remaining RV Subsidiaries' Indiana income. Hereinafter, the remaining RV Subsidiaries will be collectively referred to as the "RV Group".

The Supreme Court over the years has developed a three-part test in determining whether a unitary relationship exists: common ownership, common management, and common use or operation. *See, e.g., Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992). The first item to be considered under this three-part test is common ownership. As a general rule, at least fifty percent (50%) of a corporation's stock must be commonly owned (either directly or indirectly) in order for a corporation to be considered part of a unitary business. *See, e.g.*, 35 ILCS 5/1501(a)(27) and Tenn.Code Ann. § 67-4-2004(25)(B). The information in taxpayer's file shows that during the audit period Parent owned one hundred percent (100%) of the stock of taxpayer and the members of the RV Group. The evidence of file is sufficient to establish common ownership.

The second criteria to be considered is common management. Common management is shown when the parent corporation provides a management role that is grounded in the parent's own operation expertise and overall operational strategy. *See, e.g., Container Corp. V. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983).

Here, the taxpayer has supplied evidence which shows that Parent exercised control and influence over it and the RV Group. Parent's upper management consisted of a CEO, a Chairman and Treasurer, and a Vice President of Finance and Chief Administrative Officer. These three individuals were responsible operationally for taxpayer and the entire RV Group. Taxpayer and each one of the entities in the RV Group were required to submit to Parent's upper management for review and comment daily sales reports, monthly and annual financial reports, and operating and budget plans and goals. The CEO of Parent approved all capital expenditures in excess of one thousand dollars ($1000.00). Common management existed between Parent, taxpayer, and the RV Group.

The third test is that of common operation or use. Evidence of a common operation exists where certain functions are performed for the group by the parent (such as purchasing, financing, advertising, marketing, research, tax compliance, insurance, and pension plan management) which independent companies would perform for themselves.

In the taxpayer's case, information was supplied which shows that many of the administrative, management, and financing functions for taxpayer and the RV Group were centralized. Parent's upper management employed a purchasing agent who was responsible for negotiating national supply contracts for the RV Group. Upper management selected the independent accountants, legal counsel, and insurance carriers that provided accounting, legal and insurance services to the RV Group. Parent's upper management also coordinated the administration of the employee benefits plan for the RV Group. Upper management purchased advertising space in various recreational vehicle trade magazines for the RV Group, and the entities of the RV Group often participated in joint presentations.

On the basis of these facts, it appears that taxpayer enjoyed a unitary relationship with Parent and the RV Group. There exists the elements of common ownership and management, and a modicum flow of value between the members of the business group. Using Parent's upper management to provide services for the RV Group that the taxpayer and the RV Group could have provided for themselves, resulted in common operation.

We now turn to the next point of analysis and the question of whether requiring taxpayer and the RV Group to use a standard apportionment or separate company filing method, instead of combined return filing, would result in a distortion of the income Parent reported as Indiana source income. Ultimately, this question requires us to determine whether, under all of the circumstances of the unitary relationship between Parent, taxpayer, and the RV Group, standard apportionment fulfills the statutory purpose of avoiding distortion of and realistically portraying Indiana source income. *See* IC 6-3-2-2(p).

Although IC 6-3-2-2(q) allows a parent corporation to petition the Department to file a combined return, it also incorporates by reference the restrictions imposed on alternative methods of reporting adjusted gross income by subsection (l) of that same section. Subsection (l) states in pertinent part:

> If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> . . .
>
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The language in subsection (l) indicates that the standard apportionment and the separate accounting filing methods are the preferred methods of representing a taxpayer's income derived from Indiana sources. Other methods of income allocation and apportionment (including the combined reporting method) should only be allowed when those provided for by IC 6-3-2-2 do not fairly reflect a taxpayer's Indiana income. If the Indiana source

income in the instant case can be fairly represented on the basis of standard apportionment or separate accounting, then such filing methods should be used.

Despite the finding of a unitary relationship between Parent, taxpayer, and the RV Group, and despite the relationship between the business operations of the entities, it does not appear that the operations of the businesses were so integrated to the point where the filing of separate returns would lead to a distortion of income. The evidence on file establishes that inter-company accounts existed for inter-company transactions between Parent, taxpayer, and the RV Group. Interest was paid and received by Parent on these accounts. The balance of the amounts contained in the inter-company accounts consisted of the earnings and profits of taxpayer and the members of the RV Group. Taxpayer and the members of the RV Group were required to remit to Parent at the end of each fiscal year any and all earnings and profits. If taxpayer or a member of the RV Group was unable to remit its profits for the year, Parent charged the entity interest on the unpaid amount. The delinquent entity paid an interest rate of prime plus one percent (1%).

Additionally, the evidence on file substantiates the finding that Parent was compensated for the services that it performed for taxpayer and the members of the RV Group. The expenses incurred by Parent were allocated to the appropriate entity receiving the benefit. As such, the expenses were properly reflected on each subsidiary's financial statements.

The extensive documentation presented by taxpayer does not demonstrate that the business operations of Parent, taxpayer, and the members of the RV Group were so interconnected that it becomes impossible to accurately determine the Indiana source income attributable to the respective entities.

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax—Unitary Filing Status—Retroactive Withdrawal of Permission to File Unitary

DISCUSSION

Taxpayer next argues that it and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a unitary basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns without a finding of some material misstatement of fact.

In a letter dated October 10, 1995, the Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. However, pursuant to an audit of Parent that resulted in the disallowance of Parent's filing on a combined basis with its subsidiaries, Parent was

required to generate separate taxed returns for all of its subsidiaries, including the taxpayer and the subsidiaries with which Parent was originally granted permission to file on a unitary basis.

The statute applicable to the permission issue is found in IC 6-3-2-2 which states in pertinent part that:

> IC 6-3-2-2 Corporations and nonresidents; "adjusted gross income derived from sources in state" defined . . .
>
> (l) If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana . . .
>
> (q) . . . taxpayers may petition the department . . . for permission to file a combined income tax return for a taxable year. The petition to file a combined income tax return must be completed and filed with the department not more than thirty (30) days after the end of the taxpayer's taxable year.

(*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 1).

The Department's grant of permission to file combined returns was a determination, based upon the facts available to the Department at the time, upon which taxpayer's parent corporation could rely. However, the Department did reserve the right to revoke the grant of permission if, *inter alia*, "the facts subsequently established by the Department disclose material error or misrepresentation to the facts set forth in this petition." (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 3). This right of revocation was clearly set forth in the letter to Parent. And, the language of the letter clearly warned Parent that should a subsequent audit reveal a misrepresentation of the facts set forth originally, permission to file combined returns would be revoked.

The evidence on file evinces that the Department granted permission to Parent to include certain subsidiaries in a combined filing based upon an assertion made by Parent in its original petition letter dated August 25, 1995. In this letter, Parent stated that, "Management fees are not paid by the subsidiaries to [Parent]. [Parent] is not a profit center; therefore, no income is recognized by [Parent] from services provided to its subsidiaries." (*See Parent's Original Petition Letter* dated August 25, 1995, page 4). Upon examination of the facts purported by Parent in its petition, and pursuant to the audit, the auditor discovered inter-company transactions (including management services) that were provided by Parent to its subsidiaries at arm's length.

Notwithstanding the foregoing, we do not believe that the Audit Division's subsequent reversal of the Department's determination that taxpayer could file combined tax returns was due to a material error or misrepresentation. The original approval letter specifically stated that combined filing status would be revoked if a material error or misrepresentation was discovered. However, through its examination of the books,

records, and property of taxpayer, and its determination that separate filing best represented the taxpayer's Indiana income, Audit did not discover any material error or misrepresentation on the part of taxpayer.

Upon review of the instant case, the Department concludes that the original approval letter granting taxpayer permission to file combined tax returns is in error, but was not the result of a material error or misrepresentation on the part of taxpayer in the application process. Therefore, the appropriate remedy is for taxpayer's combined filings with the five RV subsidiaries originally permitted to be included in the combined returns for the years in question to be allowed.

FINDING

Taxpayer's protest is sustained. Taxpayer's combined returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years in question will be allowed. However, taxpayer's permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns is revoked for tax years beginning after the date of the audit report.

III. Adjusted Gross Income Tax—Consolidated Returns

DISCUSSION

Taxpayer next protests the Audit Division's determination that taxpayer and the members of the recreational vehicle group that filed Indiana tax returns were required to file separate filing reports for fiscal year ends 1995 through 1997. Taxpayer maintains that it should have been allowed to file consolidated returns with the members of the recreational vehicle group that filed Indiana tax returns for fiscal year ends 1995 through 1997, and with Parent for fiscal year ends 1996 and 1997. According to taxpayer, the filing of consolidated returns is the only way to fairly reflect taxpayer's and the subsidiaries' Indiana source income.

As we have already granted taxpayer permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years encompassed by the audit, this question is moot.

FINDING

Taxpayer's protest of this issue is moot.

IV. Adjusted Gross Income Tax — Throwback Sales

DISCUSSION

During the audit period, taxpayer and the subsidiaries that filed Indiana tax returns classified sales of recreational vehicles and parts to customers outside of Indiana (*i.e.*,

recreational vehicle dealers and other subsidiaries) as throwback sales. According to taxpayer, it and the subsidiaries were under the mistaken belief that they were not subject to income tax in states other than Indiana, Ohio, and Michigan. Taxpayer believes that because it and the subsidiaries clearly had nexus activity in all the states where the recreational vehicles dealers are located (hereinafter, the "Dealers"), sales destined to those particular states should not have been classified as throwback sales.

Sales made by Indiana corporations to out-of-state purchasers must be apportioned as income to Indiana if the state in which the purchaser resides is without legal authority to claim such income as its own. *See* IC 6-3-2-2(e) and 45 IAC 3.1-1-64. Specifically, if interstate sales are "taxable in another state" - *i.e.*, the state of the purchaser - the sales are not includible in the numerator of the Indiana sales factor. Such sales are defined as throwback sales.

According to IC 6-3-2-2(n):

> For purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if:
>
> (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or
>
> (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

Indiana's regulatory language further defines "taxable in another state." 45 IAC 3.1-1-64 states in part:

> A corporation is "taxable in another state" under the Act when such state has jurisdiction to subject it [the corporation] to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385.

The taxpayer bears the burden to prove that an assessment by the Department is invalid. IC 6-8.1-5-1.

In *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992), the United States Supreme Court interpreted the term "solicitation" for purposes of P.L. 86-272, the federal law that generally exempts a corporation from state income tax if the company's only activity in the state is solicitation of sales of tangible personal property. Wrigley also established that a *de minimis* amount of nonsolicitation activity will not cause a corporation to lose its exemption from state taxation under P.L. 86-272. In *Wrigley*, the Court found that activities ancillary to the solicitation of orders

would not result in a loss of immunity to taxation. Additionally, the Court held that as long as an activity, or activities, did not establish a nontrivial, additional connection with the taxing state it is sufficiently *de minimis* to avoid taxation. (*See also, Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754, 759 (Ind. Ct. App. 1980), where the court set out examples of activity which exceeded "mere solicitation" including "giving spot credit, accepting orders, collecting delinquent accounts and picking up returned goods within the taxing state, collecting deposits and advances on orders within the taxing state, pooling and exchanging technical personnel in a complex mutual endeavor, maintaining personal property . . . and associated local business activity for purposes not related to soliciting orders within the taxing state.")

The records and evidence presented to the Department lead to the conclusion that taxpayer and the Indiana subsidiaries contracted with Dealers outside of Indiana to perform warranty repair services. Periodic visits made by the employees of taxpayer and the Indiana subsidiaries to other states were to brief Dealers' on the products and the distinguishing features of the products in comparison with competitor's products, and to generate new business and to insure future sales of the products. These activities are all protected as ancillary to solicitation and would not subject taxpayer or any of the Indiana subsidiaries to taxation in other states. The few visits made by employees to brief Dealers on the products could be construed as *de minimis*. The Department concludes that taxpayer has not proven that it is subject to taxation in other states, and that the throwback of sales shipped to the other states were properly added into the numerator of the sales factor.

FINDING

Taxpayer's protest is denied.

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